87-2111

No.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

EASTER HOUSE,

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. In an action to review an Internal Revenue Service ruling respecting Petitioner's tax exempt status, whether the lower courts erred in weighing the credibility and good faith of the statements in the administrative record, rather than assuming the truth of such statements as required by statute and court rules.

2. Whether the Government wrongly impugned Petitioner's good faith, and improperly influenced the Court of Appeals, by including in its appellate brief an extra-record, false and scurrilous newspaper article respecting Petitioner's President.

PARTIES INVOLVED

The only parties are the Plaintiff, Easter House, and the Defendant, United States of America.

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OCTOBER TERM, 1987

No. _____

EASTER HOUSE,

Petitioner

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

Easter House, an Illinois not-for-profit corporation, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*,) is not reported. The opinion of the Claims Court is reported at 12 Cl. Ct. 476. (App. D. *infra*.)

JURISDICTION

The Judgment of the court of appeals (App. B, *infra*) was entered on March 28, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 501 and 7428 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Section 1.501 of the Treasury Regulations on Income Tax (26 C.F.R.), are set out in a statutory appendix (App. E *infra*,).[1]

STATEMENT

1. The relevant facts were contained in the administrative record compiled in proceedings conducted by the Internal Revenue Service. (A382-909.)[2] Under Section 7428 of the Internal Revenue Code, such facts are assumed to be true, and may be summarized as follows:

The Petitioner's sole activity consists of providing assistance to expectant mothers and their babies, by furnishing them with financial and in-kind medical and other aid during pregnancies and deliveries, and by thereafter placing the babies with adoptive parents. (A785). The Petitioner has never operated as a for-profit adoption service. (A784).

The Petitioner furnishes comprehensive financial support to the biological mothers and children, and provides them with the very highest quality of physical, emotional and mental care. (A576-583, 592-593.) The major items of financial support which Petitioner provides include: paying for the mother's food, rent, medical care, and other subsistence during pregnancy

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as in effect for the tax year at issue (the Code or I.R.C.).

[2] "A ___" references are to the record in the Court of Appeals.

(A579-580, 188, 592-593); paying for all hospital delivery and post-natal medical care of the biological mother and child in highest quality private hospitals (A587); and paying for extraordinary expenses of children born with genetic or other birth defects (A582-583).

The Petitioner also provides comprehensive in-kind support to the biological mothers and children of the highest quality, including counseling by professional-trained social workers regarding abortion and adoption alternatives, and medical, financial, emotional and other pregnancy problems; providing case workers to stay with biological mothers in the hospitals and delivery room (A580); and placing babies with adoptive parents, who have been investigated by the Petitioner and have been found to be able to provide good homes for the child (A787.)

By assisting the expectant mother as described above, the Petitioner also provides assistance to the baby, both before and after delivery. Prenatal medical and nutritional intervention result in healthier babies; and supervised labor, delivery, and in-hospital care assure safer births. (A783.)

Almost all of the mothers who are assisted by the Petitioner are in need of financial support for medical, housing, and food needs. (A788, 865, 866.) The vast majority of expectant mothers who entered Petitioner's program in 1984 were provided financial support for medical care and shelter. (A864, A866.) In addition to the high number of unwed and unemployed mothers, there was a significant number of mothers in other especially distressed circumstances in 1984, such as teenage mothers and mothers on drugs. (A867, A792.)

The fact that many mothers who initially decide to place their children for adoption subsequently change their minds and withdraw from Petitioner's program illustrates the focus of the program on the availability of the alternatives to the mother at any time prior to the adoption of her child. (A597.)

Petitioner's adoption placement activities are essential to accomplish its exempt charitable purposes of promoting the health and relieving the poverty and distress of the mothers and children who are benefited. (A808.) The placement activities conducted by Petitioner are not severable from its counselling and assistance activities, since it is the totality of the program that results in the well-being of both the unwanted babies and their mothers. (A808.)

Unless the unwanted infants are provided a stable home environment with parents who want them and who can provide for them, the prenatal health care and subsistence aid do not accomplish the purposes of Petitioner (A808.) Placing the babies with families which meet high standards of acceptability is the end of the continuum of charitable activities which begins with counselling expectant mothers about alternative means of providing for an unwanted pregnancy. (A808-809.) If quality counselling and health care do not lead to quality home environments for the unwanted infants, the charitable goal is only partially met. (A809.)

By providing a continuum of care and support with an accepted family ready for post-delivery placement of the baby, Petitioner can assure expectant mothers that the well-being of their babies will be provided for. (A809.) Although the expectant mothers may decide to give up their babies, assurance that the babies

will be well-cared for is an essential component of the prenatal physical and emotional health of the mother. (A809.)

For tax years 1978-1982, Petitioner's tax returns reported operating deficits or modest excesses of receipts over expenditures. (A814.) Petitioner's expenses exceeded its revenues in 1982 by $24,391. (A399.) At the end of 1982, Petitioner had cash and other liquid assets totalling only $240.23. (A399.) In 1983, its operations greatly expanded, and it had gross income of $1,032,575, expenses of $779,047, and net income from operations of $253,529. (A10, 438.) At the end of 1983—the year when the exemption application was filed—Petitioner had $99,981 in cash and other liquid assets. (A406.)

Petitioner received no federal or state financial assistance. (A806.) Petitioner depended on private providers of services (such as private hospitals, board certified obstetricians, and its own counsellors) to furnish the highest quality of services which comprised its program. (A448, 449.) The costs were all privately financed with fees received from adoptive parents. (A805.) Petitioner's normal charge for an adoption was $16,500 in 1985. (A861.)

The fees are not structured to produce a profit over and above the cost of conducting the charitable activities and providing a reasonable reserve as required by law. (A813-814.) In most cases, the fees paid by adoptive parents exceeded the expenses of the Petitioner respecting the biological mother and child (A448.) In some instances, however, the expenses exceeded the adoption fees.

The Internal Revenue Service denied Petitioner's application for tax exempt status under Code Section

501(c)(3) by letter of February 5, 1986. (A2,908.) Petitioner filed a timely declaratory judgment suit in the Claims Court pursuant to Code Section 7428. (A6,37-66.) The Claims Court held that Petitioner was not exempt on the grounds (i) that its purpose in providing assistance to natural mothers and their babies was to produce healthy babies for which high adoption fees could be charged; and (ii) that it provided excessive financial inurement to its President. (App. 31a[3].) The Court of Appeals affirmed *per curiam* in a short, unpublished memorandum. (App. la-4a.)

REASONS FOR GRANTING THE PETITION

A. Judicial Decisions Are in Conflict, and the Issue is Important.

The lower courts improperly disregarded the contents of the administrative record, which must be assumed to be true for purposes of the tax exemption proceedings under Code Section 7428. The decisions below are in conflict on this issue with the opinions in *Bethel Conservative Mennonite Church* v. *Commissioner*, 746 F.2d 388 (7th Cir. 1984); *Presbyterian & Reformed Pub. Co.* v. *Commissioner*, 743 F.2d 148 (3d. Cir. 1984); and *Plumstead Theatre Co.* v. *Commissioner*, 74 T.C. 1324 (1981), aff'd, 675 F.2d 244 (9th Cir. 1982). In those cases the courts of appeals held that the Internal Revenue Service and the courts must accept as true the facts set forth in the administrative proceedings involving applications for exempt status pending before the Internal Revenue Service.

In *Bethel*, the Court of Appeals reversed a Tax Court decision which had held, without any basis in

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[3] "App. ___" references are to the Appendices to this Petition.

the record, that a Mennonite Church's purpose in operating a mutual aid medical plan was to provide private, commercial-type insurance benefits to the church's members. The Court of Appeals held that in a Section 7428 action, the courts were bound by the facts in the administrative record—there the Church's Confession of Faith and Guiding Principles which provided that members, as a matter of religious duty, must give medical and other material aid assistance to each other. 746 F.2d at 392.

Similarly, in *Presbyterian & Reformed Publishing Co.* v. *Commissioner*, *supra* , the Court of Appeals reversed the Tax Court because it had speculated that Petitioner's religious book prices were too high, thus ignoring the administrative record facts showing that Petitioner needed the funds to build and maintain financial reserves to carry on its charitable activities, and to erect a new building.

In *Plumstead Theater Society v. Commissioner, supra*, the Ninth Circuit affirmed a Tax Court opinion (see 74 T.C. at 1330) which held that the Commissioner could not ignore facts in the administrative record evidencing the theatre society's extensive use of uncompensated volunteers. The courts accordingly held that the Society was tax exempt under Code Section 501(c)(3).

In the instant case, the lower courts refused to assume the correctness of the facts in the administrative record, but instead weighed and analyzed the good faith and credibility of Petitioner's written statements before the Internal Revenue Service, accepting some, rejecting others, and speculating about motives.

Such an analysis, although proper in an ordinary trial where witnesses testify or can be called to testify, and where the record is open until immediately before the decision, is totally erroneous in a Section 7428 action respecting the initial ruling on tax exempt status under Section 501(c)(3). In such proceedings, Tax Court Rule of Practice and Procedure 217 provides that the facts as presented in the administrative record will be deemed true. The legislative history of Section 7428 indicates that Congress intended that the Claims Court and the District Court follow the rules of the Tax Court. The Senate Report stated that "rules are to be developed by the courts under their rule making powers. . . . Insofar as is practical those rules should conform to the rules that the tax court develops with regard to declaratory judgment suits . . . ." S. Rep. No. 94-938, 94th Cong., 2d Sess. 588 (1975)

If the Internal Revenue Service believes that the facts furnished by the taxpayer for inclusion in the Administrative Record are false, its proper remedy is to issue a favorable ruling and then audit the taxpayer, with a view to revoking the exemption and assessing a tax. In those proceedings, discovery and live testimony at a trial are available.

The decision below, if allowed to stand, will have a deleterious effect on administration of the exempt organization tax laws. Practitioners will submit even more voluminous administrative records, with increasingly cumulative evidence, in an attempt to protect themselves against the court's ability to disregard statements in the administrative record. Such a development will increase the already lengthy delays at

the local and national levels in processing requests for exempt organization rulings.

Finally, as will be discussed in more detail at pages 17-19 *infra*, the Government's methods for challenging the administrative record here manifested a prejudgment, bias and prejudice totally incompatible with its proper role as an administrative tribunal under Section 7428. In its brief in the Federal Circuit, it enclosed a false, scurrilous and defamatory article from the "National Law Journal" which inferred that Petitioner's President was an unscrupulous and unlicensed "baby seller". (App. 78a-92a.) The article was not in the administrative or court record, was solely intended to lead the court to disregard the administrative records facts, and its submission constituted a gross violation of due process.

B. The Statutory Structure of Sections 501(c)(3) and 7428.

Section 501(c)(3) of the Internal Revenue Code of 1954, App. 73a-74a, *infra* , provides an exemption from federal income tax for "Corporations * * * organized and operated exclusively for * * * charitable or educational purposes * * *, no part of the net earnings of which inures to the benefit of any private shareholder or individual * * *." Section 1.501(c)(3)-1(d)(1)(i) of the Treasury Regulations on Income Tax (1954 Code), App. 74a, *infra* , provides that an organization qualifies for exempt status if it is organized and operated for one of the exempt purposes stated in the statute. Section 1.501(c)(3)-1(d)(2) of the Regulations provides that the term "charitable" is used in the statute in its generally accepted legal sense in the law of charitable trusts. See *Sound Health Association* v. *Commissioner* , 71 T.C. 158, 177-178 (1978), acq. 1981-2 C.B. 2; *Green* v. *Connally* , 330

F. Supp. 1150, 1157 (D.D.C. 1971), aff'd *per curiam sub nom . Coit* v. *Green* , 404 U.S. 997 (1971). Consequently, the term "charitable" is not limited to the specific classifications enumerated by the statute, but includes " 'any benevolent philanthropic objective not prohibited by law or public policy which tends to advance the well-doing and well-being of man'." *Hutchinson Baseball Enterprises, Inc.* v. *Commissioner* , 73 T.C. 144, 152-153 (1979). Generally accepted charitable purposes include the promotion of health (*Sound Health Association , supra*) and the care of orphans or poor illegitimate children (Rev. Rul. 80-200, 1980-2 C.B. 173; *In re Milne's Succession* , 230 La. 729, 89 So.2d 281 (1956)).

As a corollary of the "charitable, religious * * * or educational" requirement, Section 501(c)(3) and related statutes also provide that a qualifying organization must be organized "exclusively" for exempt purposes. "The presence of a single * * * [non-exempt] purpose * * * [that is] substantial in nature" will destroy the exemption. *Better Business Bureau* v. *United States* , 326 U.S. 279, 283, (1945) (emphasis added). By contrast, if a non-exempt purpose of an organization is merely "incidental" to the primary exempt purpose, then the exemption is permitted. *American Institute for Economic Research* v. *United States* , 302 F.2d 934, 938 (Ct. Cl. 1962); Treas. Regs. §1.501(c)(3)-1(e).

Finally, Section 501(c)(3) prohibits exempt status if net earnings inure to the benefit of any private shareholder or individual. It is settled that this provision does not prohibit paying reasonable compensation to officers, directors, or other staff. E.g., *Enterprise Railway Equipment Co.* v. *United States*, 161 F. Supp.

590 (Cf. Cl. 1958). Nor does the provision prohibit a tax-exempt charitable organization from giving or loaning funds to another organization to be used for charitable purposes. Rev. Rul. 67-149, 1967-1 C.B. 133; Rev. Rul. 68-489, 1968-2 C.B. 210; *Roche's Beach, Inc.* v. *Commissioner*, 96 F.2d 776, 778 (2d Cir. 1938); *Commissioner* v. *Danz Charitable Trust* , 231 F.2d 673 (9th Cir. 1955).

Organizations which are tax exempt under Section 501(c)(3) are also eligible to receive tax deductible contributions under Section 170(c)(2) and other related statutes. After this Court held that organizations may not obtain an injunction respecting tax exemption and eligibility for tax deductible contributions, Congress in 1976 enacted Code Section 7428. The latter statute allows an organization to obtain an accelerated declaratory judgment respecting its Section 501(c)(3) tax exemption and its eligibility to receive tax deductible contributions, based on the sworn administrative record.

C. The Lower Courts Erroneously Challenged The Credibility and Good Faith of Statements in the Administrative Record.

In the instant case, the lower courts refused to give effect to the administrative record and instead fabricated their own erroneous facts and conclusions in order to hold that private noncharitable benefit was a substantial purpose of Petitioner, and that net earnings of Petitioner inured to Petitioner's President. These conclusions directly conflict with the administrative record in every particular, and reflect a prejudgment and bias respecting Petitioner's good faith and veracity.

1. The courts below held that Petitioner's primary goal was charging excessively high fees for adoption.

(App. 3a.) This conclusion improperly ignores the stipulated facts in the administrative record.

In *Presbyterian & Reformed Pub. Co.* v. *Commissioner* , 79 T.C. 1070, 1086 (1982), the Tax Court held that the prices charged by a church publisher were too high to allow it to retain exempt status. The Third Circuit reversed, on the ground that the organization used the receipts for its tax-exempt functions and did not have unreasonable accumulations of profits. *Id.*, 743 F.2d 148, 156 (1984).

In the instant case, the administrative record is clear in stating that the fees charged adoptive parents by the Petitioner are solely established to cover the high costs of providing counseling, medical care, and housing, food and clothing to the expectant mothers and babies assisted by the Agency; the fees are not structured to produce a profit over and above the cost of conducting the charitable activities and providing a reasonable reserve as required by law. (A813-814.) The lower courts cited no contrary facts, but instead imputed to Petitioner bad faith for earning a "profit" in one year.

In *Presbyterian & Reformed Publishing, supra,* the Third Circuit held that the reasonableness of accumulated profits (and implicitly the reasonableness of prices) for Section 501(c)(3) purposes should be judged by accumulated earnings tax standards under Code Section 533. *Id.*, 743 F.2d at 156-158. Here, the administrative record shows that for tax years 1978-1982, Petitioner's tax returns reported operating deficits or very modest excesses of receipts over expenditures. (A814.) Petitioner had cash and other liquid assets totalling only $240.23 at the end of 1982

(A399) and only $99,981 at the end of 1983 when the exemption application was filed. (A406.)

It is well settled that, for accumulated earnings tax purposes, a corporation is entitled to have sufficient reserves of cash and liquid assets to cover one operating cycle—the time period it takes between the generation of expenses and the collection of receipts. E.g., *Atlas Tool Co.* v. *Commissioner*, 70 T.C. 86, 115 (1978). It was undisputed below that Petitioner needed $600,000-$900,000 in working capital to take it through its 6-9 month operating cycle. (See A813-816.) Plainly the Petitioner's $99,981 accumulation of earnings was significantly less than permitted under this standard. Under *Presbyterian & Reformed Publishing*, its fees were accordingly reasonable.

Moreover, other parts of the record demonstrate other charitable needs for the relative small accumulation of earnings—far more need than the available funds could satisfy. Additional amounts were necessary (i) to ensure solvency (A813-814); (ii) to allow below-cost fees to financially needy adoptive parents (A813-814); and (iii) to maintain a fund to pay catastrophic medical and other costs inherent in its obligation to pay all obstetric and child-support costs, regardless of the health or adoptability of mothers and babies in the program (A813-816.)

2. The lower courts also held, contrary to the administrative record, that Petitioner's primary purpose in providing good care to potential mothers was so that they would produce acceptable and adoptable babies for which high fees could be charged. The courts did not dispute that Petitioner provided "good care" to its pregnant women and babies—private counseling, gynecologists, counselors, hospitals, and social work-

ers of the very highest quality; free quality rent, food and other necessaries; plus a variety of other top quality services. (E.g. App. 14a-15a.) But the court's conclusion—that these comprehensive, admittedly charitable activities were primarily designed to generate profits (App. 44a-47a)—contradicts the administrative record, which states that (A808-809):

> [Petitioner's] adoption placement activities are essential to accomplish its exempt charitable purposes of promoting the health and relieving the poverty and distress of the mothers and children who are benefited. The placement activities conducted by [Petitioner] are not severable from its counseling and assistance activities, since it is the totality of the program that results in the well-being of both the unwanted babies and their mothers. Unless the unwanted infants are provided a stable home environment with parents who want them and who can provide for them, the prenatal health care and subsistence aid do not accomplish the purposes of [Petitioner]. Placing the babies with families which meet high standards of acceptability is the end of the continuum of charitable activities which begin with counseling expectant mothers about alternative means of providing for an unwanted pregnancy. If quality counseling and health care do not lead to quality home environments for the unwanted infants, the charitable goal is only partially met.

Furthermore, by providing a continuum of care and support with an accepted family

> ready for post-delivery placement of the baby, [Petitioner] can assure expectant mothers that the well-being of their babies will be provided for. Although the expectant mothers decide to give up their babies, assurance that the babies will be well-cared for is an essential component of the prenatal physical and emotional health of the mother.

3. The Court of Appeals complained that adoptive parents were charged below-normal fees "in only a few instances" (App. 3a), and that "potential mothers are no longer cared for once they decide to keep their babies." (App. 3a) In reality, the administrative record shows (and the Government admitted on appeal) that below-cost fees were charged in 3 percent of cases[4]—a higher percentage than many tax exempt hospitals provide. Moreover, the courts ignored that Petitioner never recouped (or even attempted to recoup) the average $1800 which it had paid to at least 71 mothers who left the program. (A599-602.)

The lower court erroneously stated that Petitioner should have paid expenses of mothers who left the program. In reality, most of these mothers left to have an abortion. (A204.) The record does not show whether other mothers who left ever asked for assistance after they left the program. The administrative record does state that Petitioner always pays the expenses of mothers who decide not to place their children for adoption, and lists 93 instances when such payments were made. (A582, 548, 599-602.) Twenty-two percent (22%) of the expectant mothers

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[4] A293, 426-427, 452, 582-583, 603-632. See Appellee's Brief at 5.

who received counselling or financial assistance from the agency in 1984 did not place their babies. (A865.)

4. The Claims Court held that Petitioner was not exempt because it had never conducted a fundraising drive. In fact, the administrative record shows that Petitioner properly intended to conduct fundraising after—not before—it obtained its tax exemption ruling. (A 799.)

D. The Lower Courts Also Improperly Disregarded the Administrative Record in Holding That Private Benefits Inured to the Benefit of Petitioner's President.

1. The Court of Appeals held that the $45,000 salary of Petitioner's President was excessive compensation because it was for "part time work". (App. 4a) This rationale contradicts the administrative record, which shows that Mr. Kurtz worked "40-60 hrs/wk" in his duties for the Agency. Indeed, the Government admitted in its Claims Court Brief (p. 28) that "the Administrative Record shows that Mr. Kurtz received what appears to be reasonable compensation from * * * [the Agency]." In these circumstances, whether or not other organizations paid Mr. Kurtz reasonable compensation for his work for them is both irrelevant and immaterial to the Petitioner's exempt status. The case is similar to *Presbyterian & Reformed Pub.*, *supra*, where the courts held it was irrelevant that the President there had once worked for no salary; the issue is reasonableness of salary payments from the exempt organization in the year in issue.

The courts below also concluded that Petitioner's President had received inurement because Petitioner had loaned funds to three corporations which Petitioner's President controlled. The claim that Petitioner loaned funds to one of the three corpora-

tions—Suko Corp.—is totally contrary to the Administrative Record, which shows unequivocally that there was not a loan from the Petitioner to Suko; rather, Suko made an interest free loan to the Agency. (A403, 456, 634.) This loan, together with an interest-free loan made by Petitioner's President to Petitioner, was made in a time of the Petitioner's substantial financial need. (AR 63). The loans were repaid several years later. (A456.)

The two loans made by Petitioner to other adoption organizations were plainly for charitable purposes, not for the private benefit of anyone. The administrative record states that the Petitioner loaned funds to Friends of Children, Inc., an adoption agency in Atlanta, Georgia of which Kurtz is an officer, "in support of its charitable activities" (A871-872), and that the Petitioner had "expand[ed] its charitable program by providing support to other child welfare agencies."

Similarly, the lower court incorrectly held that an $86,861 loan by the Petitioner to Tzyril Foundation, of which Mr. Kurtz was an officer and which became insolvent in 1982, constituted inurement. However, the administrative record states that such loans were part of the Petitioner's "charitable program [of] providing support to other child welfare agencies." (A816.)

E. Use and Submission of the National Law Journal Article was Unlawful and Violated Due Process Principles

The Government's contradiction of the Administrative Record facts here, which the lower courts adopted, reflects an illegal and unconstitutional bias and prejudice against Petitioner and its President. This bias and prejudice culminated in the Justice De-

partment's inclusion, in its brief on appeal, of a false and scurrilous newspaper article, which purported to link Petitioner's President with illegal baby selling operations. (See App. 78a-92a.) The article was not in the administrative record or the Claims Court record, and was solely designed to bias and prejudice the court of appeals, as part of the Government's campaign to have the court ignore the facts in the administrative record. Such action makes a mockery of Code Section 7428 and the court rules which govern such declaratory suits.

The unrestrained submission by the Justice Department of such yellow journalism to the appellate court will necessarily destroy the confidence of taxpayers in the fairness of the tax enforcement and judicial processes.[5] Moreover, such submission was particularly unlawful here, because Code Section 7428

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[5] Much of the article's characterization of the Agency's President is based on an interview with an Arizona state official who is quoted as stating that he "considers" Birth Hope, a new adoption agency recently started by Petitioner's President, to be "a grand baby selling scheme". In response, Petitioner showed that Arizona granted an adoption agency license to Birth Hope within a month of the date of the article, as proven by the license of which we asked the court to take judicial notice. (See Appendix S to Reply Brief of Appellant in the Federal Circuit.)

The article also describes in a most derogatory fashion licensing difficulties of the Agency in Illinois, and of an affiliated adoption agency in New Jersey, Missouri, and Florida and implies that those difficulties amount to "baby selling". In reality, the adoption laws of the various states are vague, complex, and stringent and legal disputes are commonplace. We referred the courts below to numerous court opinions regarding Petitioner which verify that the legal issues involved have nothing to do with charitable status under Section 501(c)(3).

constitutes the Internal Revenue Service as a quasi-judicial tribunal to assemble the administrative record and make a decision based thereon. The proffering of the extra-record *National Law Journal* article is strong evidence that the Service and the Justice Department did not base their exemption denial ruling solely on the record, but relied on non-competent, extra-record materials which were never revealed to Petitioner. Such action is a major violation of due process principles. The fundamental abuse of the statute requires this Court to review this case and issue judicial guidelines to ensure adherence to the statutory procedures.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted

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APPENDIX

APPENDIX A

Note: This opinion has not been prepared for publication in a printed volume because it does not add significantly to the body of law and is not of widespread legal interest. It is a public record. It is not citable as precedent. The decision will appear in tables published periodical

United States Court of Appeals for the Federal Circuit

87-1519

EASTER HOUSE

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

DECIDED: March 28, 1988

Before FRIEDMAN, DAVIS and MAYER, Curcuit Judges.

PER CURIAM.

DICISION

The decision of the United States Claims Court, sustaining the Internal Revenue Services' (IRS's) determination that appellant does not qualify as a tax exempt organization under 26 U.S.C. §§ 501(c)(3) and 501(a) (Easter House v. United States, 12 Cl. Ct. 476 (1987)), is affirmed.

OPINION

Appellant Easter House is an adoption agency which sought from IRS a declaration of tax exemption as a charitable organization. When this was denied, appellant brought this declaratory judgment action in the Claims Court which held that the IRS was correct. The facts are set forth in the Claims Court's exhaustive opinion, Easter House, supra, at 476.

The two issues before us are whether (i) Easter House is operated exclusively for charitable purposes, and (ii) no part of the earnings of Easter House inures to the benefit of a private shareholder or individual. On the first question, the Claims Court pointed out, as major reasons why Easter House was not operated chiefly for charitable purposes, that (a) the organization has accumulated very substantial profits, (b) large fees (which are the only source of revenue and were designed to cover all the adoption costs) are charged to the adopting parents, and these were reduced in only a few instances, (c) potential mothers are no longer cared for once they decide to keep their babies, and (d) the good care given the potential mothers is largely designed to produce

adoptable and acceptable babies. We agree, on these grounds, with the Claims Court that "the business purpose" [the placing of children for adoption at high fees] "and not the advancement of educational and charitable activities purpose" [the care of the potential mothers as well as

provision of children to parents desiring to adopt them] is appellant"s "primary goal."

The Claims Court also correctly held that a substantial part of the Easter House earnings inured to its president and only "life member," Howard Kurtz. He elects every other member of the corporation and all the other directors. He has very large powers, and received for 1983 a salary of $45,125.05 for part-time work. He also was

a compensated officer of Friends of Children, Inc. (Friends), an adoption agency comparable to appellant, as well as having "other sources of income." He likewise owned or controlled the Tzyril Foundation and Suko Corporation, both concerned with adoption of foreign children. In 1982-83 appellant Easter House made loans to Friends, Tzyril and Suko. There is not indication in the record of the purposes of these loans, but it is clear that Easter House was used by Kurtz as a source of credit to these entities he controlled. The sum of the evidence is, therefore, that it cannot be said that "no part of the net earnings" (emphasis added) of Easter House inures to the benefit of a private shareholder or individual.

APPENDIX B

United States Court of Appeals for the Federal Circuit

87-1519

EASTER HOUSE,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

JUDGEMENT

ON APPEAL from the U.S. Claiams Court

This CAUSE having been heard and considered, it is ORDERED and ADJUDGED:

AFFIRMED.

DATED March 28 1988

ISSUED AS A MANDATE: April 18, 1988

Costs: Against; Appellant

Printing.....$188.52

Total.....$188.52

ENTERD BY ORDER OF THE COURT

Francis X. Gindhart, Clerk

APPENDIX C

In the United States Claims Court

NOTICE

EASTER HOUSE, etc. No. 265-86 T

vs.

THE UNITED STATES

Clerk's Office

Washington, D.C., July 6, 1987

To Attorney of Record, Assistant Attorney General, and Judge Lydon:

Please take notice that in the above case there has been entered this day in the plaintiff's motion, filed June 24, 1987, for reconsideration

the following order by the Judge:

DENIED.

ENTERED BY ORDER OF THE COURT

Frank T. Peartree, Clerk

APPENDIX D

IN THE UNITED STATES CLAIMS COURT

No. 265-86T

(Filed:)

EASTER HOUSE, An Illinois Not-For-Profit Corporation	)	Income Tax; declaratory judgement under 26 U.S.C. § 7428 adoption agency; 26 U.S.C. § 50(c)(3)-organization exempt from
v.	)	taxation; facters which indicate commercial rather than
;	)	charitable or educational operational demeanor; inurement of earnings to private
THE UNITED STATES	)	individual.

Robert H. Kapp, Washington, D.C., attorney of record for plaintiff.

Neil v. Birkhoff, Washington, D.C., with whom was Assistant Attorney General Roger M. Olsen, attorney of record for defendant. Mildred L. Seidmen and W. C. Rapp, of councel.

O P I N I O N

LYDON, Judge: This is an action for a declaratory judgement pursuant to 26 U.S.C. § 7428 (1982) (Section 7428 of the Internal Revenue Code of 1954, as amended) 1[1] In its complaint plantiff seeks a declaration that it qualifies as an organization described in section 501 (c)(3) and therefore is exempt from taxation pursuant to section 501(a). After careful consideration of the parties' briefs and other submissions,

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[1] Unless otherwise indicated, statutory section references are to 26 U.S.C. (the Internal Revenue Code of 1954, as amended).

review of the certified administrative record, and oral argument, the court finds plaintiff is not entitled to the relief it requests for the reasons set forth below.

Facts

Plaintiff, Easter House, is an "Illinois Not-For-Profit Corporation". It was originally incorporated on May 5, 1960. Since 1962, plaintiff has been licensed by the state of Illinois to operate as an adoption agency. On December 12, 1983, plantiff's attorney sent a letter and an Internal Revenue Service (IRS) form 1023, "Application for Recognition of Exemption" by which plaintiff sought a determination letter from the IRS recongnizing plaintiff as an organization described in section 501(c)(3). On June 7, 1985, after much communication between plaintiff and the IRS, a proposed ruling denying plaintiff's application was issued by

the IRS. By letter dated July 2, 1985, plaintiff, through its attorneys, protested the proposed ruling. This letter was supplemented with letters dated September 26, 1985 and November 11, 1985, both of which included several attachment. On Feburary 5, 1986 the IRS issued a final adverse ruling as to plaintiff's tax exempt status. See sections 501(a) and 501(c)(3). On April 25,1986 plaintiff filed suit in this court, seeking the above described declaratory judgment.

Plaintiff describes its activities as a "continuum" which starts with its provision of prenatal care for pregnant women and continues through the delivery of the baby to the ultimate goal of placing the child with adoptive parents. This process begins with plaintiff's search for pregnant women. It places advertisements in the yellow pages for telephone use in metropolitan Chicago and

other cities in Illinois directed at "mothers-in-need."2[2] At one time plaintiff contemplated newspaper advertising but had no plans to do so as of 1984 or 1985. However, in its letter of August 14, 1984 (or August 15, 1984) to the IRS describing its activities, plaintiff advised that the general public was notified of the availability of its services "primarily through yellow pages and newspaper advertising * * * ." In some instances, women are referred to plaintiff by professionals such as doctors and social workers, and in other instances "word-of-mouth" produced "mothers-in-need".

Contact with plaintiff is usually initiated by a woman with an unwanted pregnancy. A woman's first contact with plaintiff is through one of its social workers who counsels the woman as to her

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[2] In 1982 plaintiff spent $43,000 on advertising. In 1983 plaintiff spent

various options concerning her pregnancy. If the woman decides to carry her baby to term, and then place it up for adoption through plaintiff, one of plaintiff's case workers meets with the woman to determine if and how much medical, housing and other financial help the woman will need. It is important to note that plaintiff provides services beyond initial counseling to the woman only if she is going to put her child up for adoption through plaintiff and demonstrates a financial need for such services. Plaintiff does not provide financial support or services to biological parents or mothers-to-be who already have access to such services or the financial means to obtain such services. Plaintiff investigates the financial means of the mother-to-be to see if she is eligible for insurance (medical, health, hospital) and whether financial support is available from

family or other sources. In 1984, 86 percent of those women who had an initial counseling with one of plaintiff's case workers received monetary assistance of some kind from plaintiff. The vast majority of these women were unwed and unemployed.

Generally, medical expenses of the biological mother who decides later not to place her child up for adoption through plaintiff are direct obligations of said mother. In some circumstances, however, plaintiff has voluntarily, or by prior agreement, paid medical expenses of a biological mother who did not place a child for adoption through plaintiff. The record does not indicate the amount of such voluntary expenditures.

Plaintiff provides a comprehensive group of services for mother-to-be who intended to place their newborns for adoption through plaintiff. These services include: (1) facilitating and

financing health and medical care; (2) nutritional counseling; (3) referrals to other social welfare agencies; (4) housing during pregnancy; (5) financial assistance for food and clothing; (6) delivery room non-medical assistance; (7) emotional support during pregnancy; (8) post-delivery counseling; and (9) foster care of the child from the time of delivery until the child is placed with the adoptive parents. These services are all provided to help ensure the health of the child.

The child's health is important to plaintiff because it can charge the adoptive parents the full adoption fee for a healthy baby. If an unhealthy baby is born, plaintiff might not be able to place the child with adoptive parents. Additionally plaintiff encounters medical expenses when it has an unhealthy child it cannot place. In some instances, plaintiff has charged a reduced fee for

those children who are difficult to place because of age, health, race or "similar circumstances." Plaintiff emphasizes to those interested in its adoption services the prenatal care it provides the mothers and the resulting quality of the children they deliver.

In 1985 the total fee charged by plaintiff for placing a child with adoptive parents was $16,500. [3] All prospective parents are charged an "initial service fee" of $1,500. This fee, usually nonrefundable [4] was termed

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[3] Plaintiff's first placement fee charged adoptive parents was $50.00. This fee increased over the years from $1,500 to $2,500 to $5,000 by 1974. In the decade following 1974, the fee rose from $5,000 to $14,000 (1983) to $15,000 (1984). The placement fees are paid at the time the child is permanently adopted. In contrast, the initial service fee of $1,500 is paid "up front". Adoptive parents are also responsible for their attorney's fees and costs in processing the adoption through the courts.

[4] If adoptive parents maintain their "qualified" status for 9 months and plaintiff is unable to place a child with them, their initial service fee will be refunded. If, however, such applicants

"regrettable" by the Illinois Department of Children and Family Services. This initial service fee is for plaintiff's investigation of the prospective parents and plaintiff's "home-study" course for the prospective parents. This investigation focuses, inter alia, on the educational and financial status and ability to pay of the adoptive parents. Plaintiff obtains the recent income tax returns of applicants for children to

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later receive a child for adoption, then the initial service fee togther with the placement fee must be paid to plaintiff. The initial service fee is forfeited to plaintiff by applicants who do not quality as adoptive parents under a letter agreement with plaintiff. Additionally, plaintiff's recent policy has been to refund the initial service fee of those couples who are not yet ready to adopt, but might be in the future. These latter applicants are generally young people who are really not ready to adopt a child but might be ready to do so at a future time. Plaintiff felt an initial service fee refund in such cases might encourage such young parents to continue their desire to adopt a child from plaintiff.

verify their income status and inquiry is made into their total assets and liabilities.

The adoption placement fee, as indicated previously, was increased to $15,000 in 1985. This figure represented a $7,000 increase from the fee of $8,000 charged by plaintiff in 1981. [5] The record does not show that plaintiff experienced an 87.5 percent increase in expenses relative to said fee increase during this period.

One result of plaintiff's fee structure was to put its adoption service beyond the reach of a sizeable segment of the population. Thus, qualified applicants who cannot afford to pay $16,500 are unable to adopt through plaintiff or, at best, reduced to taking a problem placement at a lower placement fee.

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[5] In 1981 the initial service fee was $800. It rose to $1,500 in 1982 and, according to the record, has remained at that level.

Plaintiff concedes that in most cases the fees paid by the adoptive parents more than cover the costs of the services it provided mother, child and adoptive parents. Although plaintiff has represented otherwise, the record clearly indicates that prospective adoptive parents are informed by plaintiff in the information literature furnished to them, that they are responsible for all legal expenses relative to the adoption process.

The fees charged adoptive parents are plaintiff's sole source of income. Plaintiff states it depends upon these fees to perform its services to mother, child and adoptive parents. It neither solicits nor receives contributions. Plaintiff neither receives nor seeks funding from state or federal government sources. Plaintiff claims that its fee system is not designed to produce a profit (over the costs of providing the

services and maintaining a "reasonable reserve"). For the calendar year 1983 plaintiff had a "total service income" of $1,032,575 and net income of $257,338.78, a profit margin of approximately 25 percent.

The dominant influence in plaintiff's affairs is Seymour Kurtz (Kurtz), its president and only "life member." [6] The life member elects every other member of the corporation. Kurtz is also one of plaintiff's directors. He had no active role as an officer until 1974. In 1962 and 1963 Kurtz, as attorney, provided some legal services for plaintiff and received approximately $2,000 in fees for these services. In 1973 Kurtz became one of plaintiff's directors. At this time, i.e., 1973, plaintiff was considering closing down because of the shortage of children

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[6] According to plaintiff's by-laws there are two classes of members, "life members". The "president or life member" may call a special meeting of members.

available for adoption. Kurtz became president of plaintiff in 1974. During the period 1974 - 1977, the plaintiff's activities were minimal and they placed only a few children for adoption. As the only life member Kurtz elects and qualifies all of the other directors. On its IRS form 1023, plaintiff lists five other directors in addition to kurtz.

As the sole life member of plaintiff, Kurtz enjoyed many powers. Only the life member can recommend the expulsion or suspension of another member (for or without cause). Only the life membership is transferable by inter vivos or testamentary instrument. No other membership is transferable. The life member decides what corporate affairs will be managed by the board of directors and what corporate affairs will be managed by the life member. The life member has the power, even without a board of directors' resolution, to enter

into contracts and execute drafts, notes and other forms of indebtedness on plaintiff's behalf. For Kurtz's services in 1983, he received a salary of $45,125.05. In 1982, Kurtz received a salary of 32,000.

Kurtz was associated with three other child welfare organizations at times material herein. He was a compensated officer [7] of Friends of Children, Inc. (Friends), a Georgia not-for-profit agency which provided services similar to the ones provided by plaintiff. Plaintiff and Friends shared a common principal director -- Margot Hamilton. Kurtz was also an officer of Tzyril Foundation (Tzyril), a not-for-profit organization established to coordinate adoptions of foreign children by parents in the United States. Tryril

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[7] The record shows that Seymour Kurtz (Kurtz) was an "officer" of two entities other than plaintiff, but the record does not indicate what specific office he held with them.

began its operations in the mid-1970's and ceased activity in 1982. Finally, Kurtz was the sole owner and "wholly controlled" Suko Corporation (Suko), a for-profit corporation established to provide legal services for adoption of Latin American children. At times pertinent to plaintiff's application for exemption Kurtz had "other sources of income," not otherwise explained in the record, in addition to that received from plaintiff and Friends. [8]

Plaintiff has engaged in financial transactions with all if the entities listed above. For the period ending December 31, 1982 plaintiff held a note

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[8] On December 3, 1984, plaintiff's attorneys informed the Internal Revenue Service (IRS) that Kurtz worked "full time" for plaintiff and had no "outside"source of income. By letter dated November 11,1985 the attorneys reported that Kurtz was compensated by Friends of Children, Inc. (Friends) and other sources in addition to plaintiff. The record contains no information relative to what services Kurtz provided for Friends or what his other sources of income were.

from Friends in the amount of $7,500. It also held Tzyril's note for $86,681.20.[9] Finally, Suko was indebted to plaintiff for a $6,250.00 loan. In plaintiff's 1983 financial statement it lists the note due from Tzyril. It also lists a note due from Friends, but this one is for $75,000. Apparently the Suko loan was repaid because it is not on plaintiff's 1983 financial statement. The record contains no terms or payment schedule relative to the Tzyril loan. The Friends loan was explicitly made without any terms of repayment schedule.

While plaintiff was applying to the IRS for tax exempt status, a hearing officer of the Illinois Department of Children and Family services recommended

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[9] At the time this debt was listed Tzyril Foundation was inactive, possessed no assets, and was most probably unlikely to repay the note. Plaintiff claims that Tzyril had been "intended" as an organization which would qualify for tax exemption. Plaintiff planned to write off the Tzyril note as a bad debt according to its 1983 financial statement.

that plaintiff's license to operate as an adoption agency not be renewed because of non-compliance with the state child welfare agency requirements. On May 17,1985 a state court ordered a Stay of Enforcement of this state administrative decision. The recoed contains nothing further relative to the status of the state court proceedings. 10[10]

As stated previously, by letter dated Feburary 5,1986, the IRS issued its adverse ruling on plaintiff's application for tax exempt status under section 501(c)(3). The IRS found that plaintiff was not operated exclusively for tax exempt purposes within the meaning of section 501(c)(3). It stated that plaintiff operated in a manner not "distinguishable from a commercial

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[10] Under present circumstances it is not deemed material for this opinion to engage in any extended discussion of the state court proceedings. It is enough to note that plaintiff was a licensed agency when it applied for exempt status from the IRS.

adoption agency." Therefore, said the IRS, a substantial purpose of the adoption activity was a non-exempt commercial purpose. Furthermore, the IRS found plaintiff failed to prove that none of its net earnings inured to the benefit of a private individual and that it did not serve private individuals.

On April 25, 1986 plaintiff filed its complaint in this court seeking a declaratory judgment under section 7428 with respect to its section 501(c)(3) status. Plaintiff alleged two grounds for relief. First, Plaintiff alleged that the IRS Commissioner (Commissioner) had erroneously determined that it did not qualify as a charitable and educational organization under section 501(c)(3). Second, plaintiff alleged that the Commissioner abused his discretion in denying plaintiff tax

exempt status because many similar organizations have been granted exemptions.

Discussion

Section 7428 permits this court, along with the Tax Court and the United States District Court for the District of Columbia to issue a declaratory judgment relative, inter alia, to an organization's initial qualification as an organization described in section 501(c)(3). An organization described in section 501(c)(3) is exempt from taxation pursuant to section 501(a). In order to invoke section 7428 plaintiff must first exhaust its administrative remedies and bring suit within 90 days after the IRS has made its final adverse determination. In the case at bar, plaintiff has satisfied these jurisdictional prerequisites.

The scope of review in this type of case is usually limited to the administrative record. This is particularly true in initial determination cases such as the case at bar. The Church of the Visible Intelligence that Governs the Universe v. United States, 4 Cl. Ct. 55, 60 (1983); Dumaine Farms v. Commissioner, 73 T.C. 650, 663 (1980); Houston Lawyer Referral Service v. Commissioner, 69 T. C. 570, 574 (1976). Only upon a showing of good cause will a court allow a party to introduce additional evidence that was not part of the administrative record. Church of the Visible Intelligence v. United States, supra, 4 Cl. Ct. at 60; First Libertarian Church v. Commissioner, 74 T.C. 396, 398 (1980); see also Unitary Mission Church v. Commissioner, 74 T.C. 507,515 (1980), aff'd, 647 F. 2d 163 (2d Cir. 1981). Thus, judicial review in this case is confined to the materials that

are contained in the administrative record filed with the court. See Church of the Visible Intelligence v. United States, supra, 4 Cl. Ct. at 60; Church in Boston v. Commissioner, 71 T.C. 102, 105 (1978). This is not to say, however, that matters outside the administrative record may not be taken into account by a court in special situations. No such special circumstances exist in this case.

The legislative history of section 7428 makes it clear that Congress intended that this court follow the practices of the Tax Court in Section 7428 declaratory judgment actions. See Church of the Visible Intelligence v. United States, supra, 4 Cl. Ct. at 60. The Tax Court rules governing this type of case provide that facts in the administrative record are deemed true and that the plaintiff/taxpayer has the burden of proving that the IRS determination was wrong. Tax Court Rule

of Practice and Procedure 217. Thus the court will assume that the facts in the administrative record before it are true. See Church of the Visible Intelligence v. United States, supra, 4 Cl. Ct. at 60. It is plaintiff's burden to prove that the determination by the IRS, based on those facts, was incorrect. See id.; Incorporated Trustees of Gospel Worker Society v. United States, 510 F. Supp. 374, 377 n.6 (D.D.C. 1981), aff'd, 672 F. 2d 894 (D.C. Cir. 1981), cert. denied, 456 U.S. 944 (1982). Finally, the fact that an entity is organized under a "not-for-profit" state statute, as is the situation in this case, carries little or no weight in consideration of the issues at hand. The focus of the court's inquiry must be on the manner of the operation of plaintiff's business. See Senior Citizens Stores, Inc. v. United States, 602 F. 2d 711, 713 (5th Cir. 1979).

The IRS determination that plantiff challenges through this action is one in which the IRS found that plaintiff did not qualify as an organization described in section 501(c)(3) An organization that does qualify as an organization described in section 501(c)(3) is exempt from taxation pursuant to section 501 (a). To qualify under section 501(c)(3) an organization must, inter alia: (1) be organized and operated exclusively for a tax-exempt purpose; and (2) not have any of its net earnings inure to the benefit of any private shareholder or individual. Because the requirements are stated in the conjunctive they all must be met. Lowry Hospital Association v. Commissioner, 66 T.C. 850, 857 (1976). Failure to satisfy one requirement means there is no exemption, i.e., the organization does not qualify under

section 501 (c)(3). Church of the Visible Intelligence v. United States, supra, 4 Cl. Ct. at 61.

It is also important to note that the first requirement set forth above is really "two requirements in one." In order to qualify under section 501(c)(3) an organization must show that it is organized and operated exclusively for tax exempt purposes. Id.; Treas. Reg. § 1.501(c)(3)-1(a)(1); see also Treas. Reg. §§ 1.501(c)(3)-1(b) and 1.501(c)(3)-1(c); Church of the Invisible Intelligence v. United States, supra, 4Cl. Ct. at 61; General Conference of the Free Church v. Commissioner, 71 T.C. 920, 926 (1979). In the case at bar the IRS determined, inter alia. that plaintiff was not operated exclusively for tax exempt purposes. The final adverse ruling of February 6, 1986 makes no reference to plaintiff's organizational status. The parties' briefs address the correctness

of the IRS determination concerning the operation of plaintiff but are also silent relative to plaintiff's organizational status. Because failure to satisfy any one of the section 501(c)(3) requirements is fatal to an organization attempting to qualify under that section,and the court finds that the IRS correctly determined that plaintiff failed to satisfy two requirements other than the organizational requirements, the court need not address the issue of whether or not plaintiff was organized for tax exempt purposes and expresses no opinion relative thereto.

As mentioned above, the IRS did determine that plaintiff was not operated exclusively for tax exempt purposes. The "operational test", used to determine if an organization is operated exclusively for tax exempt purposes , is set forth in Treas. Reg. § 1.501(c)(3)-1(c)(1). It is the organization's burden to show that

the IRS erred in determining that the organization does not satisfy the operational test. Dumaine Farms v. Commissioner, supra, 73 T.C. at 663; B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352, 356 (1978); Hancock Acdemy of Savannah, Inc. v. Commissioner, 69 T.C. 488, 492 (1977). An organization will pass the operational test, i.e., be viewed as operating exclusively for one or more exempt purpose, only if it engages primarily in activities which accomplish one or more such exempt purpose specified in section 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1); Dumaine Farms v. Commissioner, supra, 73 T.C. at 663. In the context of the operational test, the word "exclusively is a term of art. "Exclusively" does not mean "solely". See Church in Boston v. Commissioner, supra, 71 T.C. at 106. The term "exclusively" means that not more than an insubstantial part of an

organization's activities are in furtherance of a non-exempt prupose. Treas. Reg. § 1.501(c)(3)-1(c)(1). A single substantial activity in furtherance of a non-exempt purpose disqualifies an organization from exemption, despite the presence of any other exempt purposes. Fraternal Medical Specialist Services, Inc. v. Commissioner, 49 T.C.M. 289, 292 (1984); see also Better Business Bureau v. United States, 326, U.S. 279, 283 (1945). 11[11]

In addition to the requirements contained in the operational test set forth in Treas. Reg. § 1.501(c)(3)-1(c)(1), it is important to note that an organization may qualify under section

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11 Although Better Business Bureau v. United States, 326 U.S. 279 (1945) was concerned with section 811(b)(8) of the Social Security Act, that section's terms were substantially similar to those of section 501(c)(3) and citation to Better Business Bureau v. United States, supra, is appropriate in section 501 (c)(3) cases. American Institute for Economic Research v. United States, 157 Ct. Cl. 548, 554 n.1, 302 F 2d 934, 937 n. 1 (1962).

501(c)(3) if it operates a trade or business as a substantial part of its activities, provided that the operation of the trade or businness is in furtherance of the organization's tax exempt purpose and the organization is not organized and operated for the primary purpose of carrying on an unrelated (taxable) trade or business,as described in section 513. Treas. Reg. § 1.501(c)(3)-1(e); see B.S.W. Group Inc. v. Commisioner, supra, 70 T.C. at 357.

Although decided prior to the promulagation of the pertinent regulations, there is Court of Claims precedent which addresses the qualification for exemption in a manner consistent with the current regulations and related case law. The Court of Claims has held that the key to determining whether an organization, which at first blush might appear to be engaged in commercial activities that

would disqualify it from exemption under section 501(c)(3), is qualified for exemption is whether the business purpose of the activities is incidental to the charitable purpose or vice versa. American Institute for Economic Research v. United States, 157 Ct. Cl. 548, 555, 302 F. 2d 934, 937-38 (1962), cert. denied. 372 U.S. 976 (1963); Scripture Press Foundation v. United States, 152 Ct. Cl. 463, 471, 285 F. 2d. 800, 805 (1961) cert. denied, 368 U.S. 985 (1962). See also B.S.W. Group, Inc. v. Commissioner, supra, 70 T.C. at 357. This analysis is consistent with current law that: (1) a qualifying organization's activities must be primarily (not less than substantiately) in furtherance of an exempt purpose [12] Treas. Reg. §

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[12] The key factor is the purpose of the activity and not the nature of the activity. Fraternal Medical Specialist Services, Inc. v. Commissioner, 49 T.C.M. 289, 291 (1984); B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352-57 (1978). This is further supported by the fact that a qualifying organization can engage

1.501(c)(3)-1(c)(1); Fraternal Medical Specialist Services, Inc. v. Commisioner, supra, 49 T.C.M. at 291, and (2) any trade or business operated by the organization in furtherance of an exempt purpose is acceptable, so long as that trade or business, qua trade or business, does not become primary to the organization's exempt purposes, Treas. Reg. § 1.501(c)(3)-1(e). It is this two-pronged analysis that the court will use in reviewing the IRS determination relative to plaintiff's operational status.

In the instant case, plaintiff provides services for unwed mothers and children incident to its operation of an adoption service. Plaintiff's claims that the services provided for the mothers and children qualify as exempt purposes recognized under section

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in a trade of business so long as the trade or business furthers an exempt purpose. Treas. Reg. § 1.501(e)(3)-1(e).

501(C)(3). There was never an IRS determination on this specific point. Rather it focused on the nature of the adoption service offered by plaintiff.

For purposes of the present discussion the court can assume that the services provided to the mothers and children qualified as exempt purposes under section 501(c)(3). However, see note 14, infra. The key inquiry would then become whether or not plaintiff's adoption service prevents it from qualifying under the operational test as a tax exempt organization.

Under the first guideline set out above, if plaintiff's adoption service itself constituted an exempt purpose under section 501(c)(3), or if the adoption service was not more than an insubstantial part of plaintiff's activities, the existence of the adoption service would not prevent qualification. It is obvious, and deserves little

comment, that the adoption service is by no means an insubstantial portion of plaintiff's activities. The adoption service provided all of plaintiff's revenues. Placing a child for adoption is also the ultimate goal of plaintiff.

Section 501(c)(3) does not contain "adoption sevice" as one of its exemptions. 13[13] Plaintiff claims that

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[13] Despite some attempted inferences in that direction. plaintiff offers no authority that an adoption service (such as the one plaintiff runs) is a charitable purpose per se, under section 501(c)(3). Plaintiff argues most vigorously that an adoption agency is "inherently charitable." As "proof" of this cintention, plaintiff states that there are many adoption agencies which qualify for "not-for-profit" status and those adoption agencies which are operated for profit provide only a very small portion of the overall adoptions. Of course the fact, which plaintiff admits, that there are for-profit adoption agencies must call into question the supposed "inherently charitable" nature of adoption agenceis. Plaintiff's position is premised on its argument that for-profit adoption agencies are the exception to the inherently charitable rule. It states that the IRS has done nothing to show that plaintiff is within this exception. Such a claim by plaintiff appears to be an attempt on its part to shift its burden of proof to entitlement to an exemption. See

its adoption service is at the end of a "continuum" which begins with educational and charitble services for unwed mothers and their babies. The adoption service, plaintiff argues, is not severable from the educational and charitable services it provides. Because adoption services do not in and of themselves constitute an exempt purpose, plaintiff must really argue that its adoption service is primarily in furtherance of other exempt purposes, i.e., the adoption service's place on the "continuum" is such that this activity furthers the exempt purposes of providing educational and charitable services to the unwed mothers and children. The court finds it does not.

The Revenue Ruling plaintiff cites, Rev. Rul. 80-200, 1980-2 C.B. 173 is distinguishable from the case at bar. That ruling stated that the care of

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discussion, supra, p. 10 relative to "not-for-profit" organizations.

orphans and the placement and adoption of orphans constituted charitable activities. Plaintiff does not care for or place orphans. Additionally, in Rev. Rul. 80-200 the agency relied on contributions as well as fees for its support. Plaintiff receives no contributions, nor does it solicit or seek contributions.

All of the services provided by plaintiff to the unwed mothers and children could ostensibly be provided without the adoption service. Plaintiff argues that the adoption service is integral to the unwed mothers'prenatal care because it provides them with "peace of mind" that their babies will have a good home after delivery. Yet this hardly seems to support a contention that the adoption service is operated primarily for accomplishing educational and charitable purposes.

Of course plaintiff contends that the adoption service is operated in furtherance of providing educational and charitable services to the unwed mothers and children because the adoption servece provides the funding for the exempt purposes. Funding an exempt activity can in and of itself constitute an exempt activity. See World Family Corp. v. Commissioner, 81 T.C. 958, 963 (1983). This contention calls into question whether providing funding for the educational and charitable services is the primary purpose for which plaintiff operates the adoption agency or whether there is some other purpose (s) served by the adoption agency which removes the "primary" from the purpose of providing funds.

This consideration dovetails into the second of the guidelines set forth above. The adoption service provided by plaintiff is in the nature of a trade or

business. Operation of a trade or business does not automatically negate an organization qualifying for an exemption. See Treas. Reg. § 1.501(c)(3)-1(e). However, the organization must be operated primarily to carry on an exempt purpose. Thus the relevant inquiry again is: does plaintiff's adoption service primarily further exempt purposes or other purposes. or other. Put another way, is the promotion of exempt purposes primary to business purposes or vice versa? This is a question of fact to be decided on the evidence in the record. B.S.W. Group, Inc. v. Commissioner, supra, 70 T.C. at 357 (citations omitted).

The court finds that the business purpose, and not the advancement of educational and charitable activities purpose, of plaintiff's adoption service is its primary goal. Plaintiff is in competition with other adoption services.

Thus it is competing with other commercial organizations providing similar services. This is far different than an organization which solicits charitable contributions. Plaintiff's competition provides its activities with a commercial hue. See American Institute for Economic Research v. United States, supra, 157 Ct. Cl. at 555, 302 F. 2d. at 938. "Competition with commercial firms is strong evidence of the predominance of non-exempt commercial purposes." B.S.W. Group, Inc. v. Commissioner, supra, 70 T.C. at 358.

Plaintiff in past years has accumulated very substantial profits. The court realizes that the presence of profits does not automatically prevent an organization from qualifying under section 501(c)(3). See Industrial Aid for the Blind v. Commissioner, 73 T.C. 96, 101 (1979). However, the existence of profits certainly can be indicative of

a business purpose. See Scripture Press Foundation v. United States, supra, 152 Ct. Cl. at 468, 285 F. 2d at 803; B.S.W. Group, Inc. v. Commissioner, supra, 70 T.C. at 357. The substantial fee plaintiff charged were not incidental to plaintiff's exempt purposes but rather admittedly were designed to make a profit. See Scripture Press Foundation v. United States, supra, 152 Ct. Cl. at 472, 285 F. 2d at 804. The profit-making fee structure of the adoption service looms so large as to overshadow any of its other purposes. See id. at 475, 225 F. 2d. at 807. It is also noted that plaintiff's only source of income was the fees charged adoptive parents. This is a factor indicating the commercial character of the operation. See B.S.W. Group, Inc. v. Commissioner, supra, 70 T.C. at 359-60. The fact that plaintiff never solicited, nor does it plan to solicit charitable contributions to

further its operation is another factor indicating a commercial operation. Id. at 359. See also Federation Pharmacy Services, Inc. v. Commissioner, 625 F. 2d 804, 808 (8th Cir. 1980).

In its moving brief, plaintiff offers three reasons why it must accumulate profits. In its reply brief plaintiff offers a fourth reason. None are persuasive. First, it cites to a state law requiring that an adoption agency maintain financial stablity. Yet this law indicates only that an agency must maintain "financial solvency". It says nothing about accumulating profits. Next, it says that the profits are needed as a sort of self insurance for certain contingencies. There is nothing in the record to suggest that insurance for these contingencies is not available through conventional insurers. Additionally, it says that it needs the profits to provide for various services

to the unwed mothers and children. However, plaintiff also claims that the fees paid by the adoptive parents cover these services. 14[14] Finally, plaintiff states it is planning to purchase a residential facility because the cost of rent is so high. The record is devoid of any evidence of this. The pages plaintiff cites merely says that plaintiff had to expend high sums of rental property it would not have had to spend if it owned its own facility.

Plaintiff's response to the deficiencies in the record relative to the above discussion on the reasons for

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[14] As mentioned above, in order to facilitate discussion and give plaintiff's argument full rein, the court has proceeded under the assumption that plaintiff provides exempt educational and charitable services to unwed mothers and children. Yet in examing the business versus exempt purposes of the adoption service the court notes that these services are also designed to produce healthy babies. This is important to plaintiff because it can charge full fees for healthy babies and healthy babies allow it to minimize its health care costs.

accumulation is as follows. In various submissions to the IRS during the application process plaintiff made some of the same arguments it makes here concerning the reasons for accumulating profits. These arguments were made in memoranda which are now included in the administrative record. Therefore, says plaintiff, these reasons for profit accumulation contained in these memos must be accepted as true. Plaintiff fails to distinguish the difference between its arguments and facts. An argument made by plaintiff during the administrative process is not somehow converted into an unreviewable fact by having been included in the examining the merits of plaintiff's argument which is presented to it.

The IRS also found that plaintiff failed to qualify as an organization described in section 501(c)(3) because plaintiff failed to establish that no

part of its net earnings inured to private individuals or that plaintiff served private individuals. Pursuant to section 501(c)(3) an organization does not qualify for tax exempt status if any of its net earnings inures to the benefit of any private shareholder or individual. 15[15] The phrase "private shareholder or individual" refers to persons having a personal and private interest in the activities of the organization. Treas.

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15 The Tax Court has held on more than one occasion that the requirement prohibiting inurement to private shareholders and individuals is redindant to the operational test since in order to qualify as operating for an exempt purpose an organization must provide a public not a rivate benefit. Unitary Mission Church v. Commissioner, 74 T.C. 507, 512 n. 7 (1980), aff'd, 647 F. 2d 163 (2d Cir. 1981); Western Catholic Church, v. Commissioner, 73 T.C. 196, 209 n. 27, 213 (1979), aff'd, 631 F. 2d 736 (7th Cir. 1980). Nevertheless, in the case at hand, the IRS separately stated that plaintiff was not operated for an exempt purpose and had not proven its net earnings did not inure to the benefit of a private shareholder or individual. As a result, the court will undertake a separate analysis if the inurement issue in the interest of sequential completeness.

Reg. §§ 1.501 (c)(3)-1(c)(2); 1.501(a)-1(c). Furthermore, an organization is not organized and operated exclusively for section 501(c)(3) purposes if it serves a public rather than private interest. Treas. Reg. 1.501(c)(3)-1(d)(1)(ii).

Plaintiff argues that the IRS never named the individuals to whom its net earnings inured nor named the private individuals plaintiff served. Therefore, plaintiff contends, the IRS determination was wrong. This argument appears to be an attempt on the part of plaintiff to shift the burden of proof it must satisfy in order to establish its exemption. It is the taxpayer who must prove its entitlement to an exemption. The Founding Church of Scientology v. United States, 188 Ct. Cl. 490, 496, 412 F. 2d 1197, 1200 (1969). It is the taxpayer who must demonstrate that no part of its earnings inured to the benefit of any

private individual. The Basis Unit Ministry of Karl Schurig v. Commissioner, 670 F.2d 1210, 1211, 1213 (D.C. Cir. 1982). Likewise, it is the responibility of an organization to establish that it serves a public rather than private interest. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). Plaintiff cannot make up for the lack of an affirmative showing on its part that there is not any inurement or service to private interests by claiming that the IRS has not proven that there is . The IRS does not have to "prove" anything. It is plaintiff's burden to prove its net earnings do not inure to the benefit of a private shareholder or individual or that it does not serve a private interest.

The term "net earnings" in section 501(c)(3) allows an organization to incur ordinary and necessary expenditures in its operations without losing its tax exempt status. The Founding Church Of

Scientology v. United States, supra, 188 Ct. Cl. at 496,412 F.2d at 1200. One of those ordinary and necessary expenditures is the payment of reasonable salaries. Thus payment of a reasonable salary to an employee of the organization does not automatically result in inurement. Id.; Fraternal Medical Specialist Services, Inc. v. Comissioner, supra, 49 T.C.M. at 292. However, payment of an excessive salary will result in inurement. The Founding Church of Scientology v. United States, supra, 188 Ct. Cl. at 496, 412 F. 2d at 1200; Unitary Mission Church v. Commissioner, supra, 74 T.C. at 514. Whether a salary is reasonable or excessive is a question of fact. Unitary Mission Church v. Commissioner, supra, 74 T.C. at 514. One of the factors used in determining the reasonableness of a salary is whether or not an individual works for an organization full time.

Income received from other sources is an indication that the recipient is not employed on a full time basis by the organization. The Founding Church of Scientology v. United States, supra, 188 Ct. Cl. at 498, 412 F. 2d at 1201.

Net earnings may inure to an individual in ways other than the payment od excessive salaries. For example, the existence of a private source of loan credit from an organization's earnings may amount to inurement. The Founding Church of Scientology v. United states, supra, 188 Ct. Cl. at 499, 412 F. 2d at 1201; Unitary Mission Church v. Commissioner, supra, 74 T.C. at 515.

It is also important to note that section 501 (c)(3) specifically provides that "no part" of the organization's net earnings may inure to a private shareholder or individual. This means that any inurement, regardless of amount, will prevent an organization from

qualifying under section 501 (c)(3). The Founding Church of Scientology v. United States, supra, 188 Ct. Cl. at 497, 412 F. 2d at 1200; Unitary Mission Church v. Commisioner, supra, 74 T.C. at 513.

As mentioned above, the IRS determined that plaintiff failed to prove that none of its net earnings inured to the benefit of a private individual. Defendant argues that inurement is supported by two factors: (1) the size of Kurtz's salary and the amount of any other income from other sources and (2) loan transactions made by plaintiff. Plaintiff asserts these issues were never raised until the present litigation. However, the record shows that the IRS was concerned about, and placed plaintiff on notice relative to these two issues during the administartive process.

The court finds the IRS conclusion supportable on the record before it. It is well settled that plaintiff must

satisfy all the requirements for a tax exempt organization. See Western Catholic Church v. Comissioner, 73 T.C. 196, 207, aff'd, 631 F. 2d 736 (7th Cir. 1980). Indeed, on this record, the court is persuaded that plaintiff could not make such a showing because part of its net earnings clearly inured to the benefit of Kurtz, plaintiff's president and sole life member. As president and sole life member, Kurtz qualifies as a private shareholder or individual as defined by the pertinent regulations. Treas. Reg. §§ 1.501(c)(3)-1(c)(2) and 1.501(a)-1(c).

Kurtz was paid a salary of in excess of $45,000 for his work for plaintiff in the year 1983. That same year, he was also compensated by another adoption agency, Friends, and also received income from "other sources." The record does not disclose how many hours per week Kurtz worked for

plaintiff. As pointed out above, the presence of at least two other sources of income would indicate Kurtz's salary of over $45,000 was for part time employment with plaintiff. See The Founding Church of Scientology v. United States, supra, 188 Ct. Cl. at 498, 412 F. 2d at 1201.

Additionally, plaintiff has provided loans to three organizations which Kurtz was either employed by or owned. Coupled with his status as a "life member" of plaintiff, this factor takes on added significance. A loan in excess of $86,000 was made by plaintiff to the Tzyril Foundation. The record contains nothing concerning any terms or repayment schedule relative to this loan. However, plaintiff's 1983 financial statement does indicate that plaintiff planned to write off the Tzril loan as a bad debt. The 1983 financial statement also showed a loan outstanding to Friends in the amount of $75,000. The record

shows that this loan to Friends was expressly made without any terms or repayment schdule. Finally a smaller loan for over $6,000 was made by plaintiff to the Suko Corporation. From all indications in the record, this loan was repaid.

Plaintiff claims that the Friends and Tzyril loans should not disqualify it from exempt status because thay were made to organizations similar to itself for charitable purposes. There is absolutely no evidence in the record relative to the purposes of these loans. The loan to Suko was made to a for-profit corporation. Apparently the loan was not outstanding at the time of plaintiff's application. Nevertheless the fact that it was made shows that companies controlled by Kurtz had a source of loan credit in plaintiff. The existence of a source of credit is what it important. The Founding Church of Scientology v.

United States, supra, 188 Ct. Cl. at 499, 412 F. 2d at 1201; Unitary Mission Church v. Commissioner, supra, 74 T.C. at 515.

The totality of facts contained in the record certainly shows that a portion of plaintiff's net earnings inured to the benefit of Kurtz. His $45,000 salary for part time employment and utilization of plaintiff as a source of credit for other corporations add up to inurement as defined by the pertinent regulations and case law. 16[16]

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16 In its adverse determination of February 6, 1986, the IRS also referred to plaintiff's failure to prove that it did not serve a private interest. An organization will not qualify as being operated exclusively for exempt purposes if it serves a private rather than a public interest. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii); Goldsboro Art League, Inc. v. Commissioner, 75 T.C. 337, 343 (1980); Callaway Family Association v. Commissioner, 71 T.C. 340, 344 (1978); Baltimore Health and Welfare Fund v. Commissioner, 69 T.C. 554, 557 (1978). Apparently picking up on a point raised in the IRS proposed ruling of June 7, 1985, plaintiff argues that providing services to limited class, i.e., adoptive parents, does not mean that it serves a private interest. This contention may be correct as a generality. The concept of providing a

As a final issue, plaintiff attacks the IRS determination by dressing its argument in the traditional garb of an administrative review claim. Plaintiff contends that the IRS abused its discretion by determining that plaintiff did not qualify as a section 501(c)(3) organization because it has made favorable determinations for adoption agencies similar to plaintiff.

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private benfit is usually limited to the organization's insiders. Sound Health Association v. Commissioner, 71 T.C. 158, 185-86 (1978). In both Baltimore Health and Welfare Fund v. Commissioner, supra, and Callaway Family Association v. Commissioner, supra, exemptions were denied bacause the organizations served purposes which benefited the private interests of their members. However, such an argument does nothing to take away from the fact that a portion of plaintiff's earnings inured to the benefit of Kurtz. The circumstances of this case show plaintiff's close ties to outside organizations, for example, plaintiff and Friends share a common principal director and two members of plaintiff's Board of Directors also sit on the Board of Directors of Friends. Too, Kurtz was a prominent figure in both organizations and functioned as an important official in these organizations.

Of course plaintiff's argument flies right in the face of the general rule that it must establish its own exemption qualification. See The Founding Church of Scientology v. United States, supra, 188 CT. Cl. at 496, 412 F. 2d at 1200. Yet plaintiff relies on International Business Machines Corp. v. United States, 170 Ct. Cl. 357, 343 F. 2d 914 (1965), cert. denied, 382 U.S. 1028 (1966) as carving out an exception to this general rule. It is true that in International Business Machines Corp. v. United States, supra, the Court of Claims held that there were certain situations in which a taxpayer seeking an exemption could successfully point to the treatment another taxpayer was receiving in order to support an exemption claims. Id. at 365, 343 F. 2d at 919. However, these exceptions to the general rule are specifically provided by Congress. Id. Moreover, the International Business

Machines Corp. holding, as a precedent, has been severely circumscribed. Kretsch v. United States, 172 Ct. Cl. 378, 391 n. 14, 348 F. 2d 932, 940 n. 14 (1965), cert. denied, 382 U.S. 957 (1966); se also Bornstein v. United States, 170 Ct. Cl. 576, 586 n. 2, 345 F. 2d 558, 564 n. 2 (1965); Carpenter v. United States, 7 Cl. Ct. 732, 739-40 (1985), aff'd, 740 F. 2d 91 (Fed. Cir. 1986). 17[17] There is nothing in the record before the court which would support its application to the facts at hand.

In the matter of qualifying for a charitable exemption under section 501(c)(3), the court finds no Congressional mandate that the general rule that a taxpayer must establish its

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[17] It is interesting to note that Judge Davis, the author of the opinion in International Business Machines Corp. v. United States, 170 Ct. Cl. 357, 343 F. 2d 914 (1965), cert denied, 382 U.S. 1028 (1966), sought to limit the "equality of treatment" principle in his opinion in Righter v. United States, 194 Ct. Cl. 400, 431-35, 439 F. 2d 1204, 1221-24 (1971) (dissenting opinion).

own exemption should not be followed. Additionally, applicable Treasury Regulations suggest the contrary. First, the regulations speak in terms of tests that an organization must satisfy in order to establish its exemption. Treas. Reg. §§ 1.501(c)(3)-1(a), 1(b)(1) and 1(c)(1). Second, Treas. Regs. § 1.501 (c)(3)-1(d)(1)(ii) provides that in order to show that an organization is organized and operated exclusively for tax exempt purposes, "it is necessary for [the] organization to establish" it is not organized and operated to benefit private individuals. Id. (emphasis added).

More importantly, the case at bar and International Business Machines Corp. v. United States, supra, simply present two extremely different situations, both factually and legally. In the latter case the Court of Claims had before it enough evidence to show that the taxpayer's exemption claim concerned

machinces that were virtually identical to the machines produced by Remington Rand, its competitor, who was receiving an exemption. In the present case the court is confined to the information contained in the administrative record. This record contains information on only one of the organizations plaintiff claims is exempt, i.e., The Golden Cradle. The information relative to The Golden Cradle simply does not suggest the same degree of identicalness as to circumstances between plaintiff and The Golden Cradle as was contained in International Business Machines Corp. v. United States, supra, between IBM and Remington Rand.

The court finds that plaintiff's "abuse of discretion" argument is misplaced because it ignores plaintiff's burden to prove its own exemption and tries to introduce an element of reliance upon other taxpayers' exemptions to support its exemption. Generally, a

taxpayer cannot premise its right to an exemption by showing that others have been treated more generously, leniently or erroneously by IRS. The fact that there may be some taxpayers who have avoided paying a tax does not relieve other similarly situated taxpayers from paying their taxes. Wagner v. United States, 181 Ct. Cl. 807, 817-18 387 F.2d 966, 972 (1967). This general rule was recognized in International Busines Machines Corp. v. United States, supra, 170 Ct. Cl. at 365, 343 F.2d at 919, relied on by plaintiff, but not applied in that case because of circumstances unique to that case. No such unique circumstances are present in the case at bar. Accordingly, the general rule, set out above, is for application relative to plaintiff's argument of abuse of discretion by the IRS.

Even addressing the merits of plaintiff's contention, the court finds the adverse determination cannot be viewed as an abuse of IRS discretion. In the case at bar, the IRS made its determination on the basis of plaintiff's application and materials submitted in support thereof. On the basis of those materials before the IRS, which were provided by plaintiff, the IRS setermination is supported by substantial evidence and certainly does not manifest an abuse of discretion. Unlike the situation in International Business Machines Corp. v. United States, supra, 170 Ct. Cl. at 357, 343 F.2d at 914, where the critical issue was the interest of equality and fairness relative to private revenue rulings dealing with identical machines in the same or comparable situations, the case at bar does not involve private revenue rulings directed at identical or comparable

situations, as far as this record is concerned. Instead, this case involves its own particular, and perhaps unique, set of circumstances which generated the IRS determination under attack. The fact that other adoption agencies may have qualified for exemption is immaterial under the facts of this case. 18[18]

In rejecting plaintiff's application for exempt status under section 501(c)(3), the IRS found that

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18 These other adoption agencies may have made a better showing on the administrative record than plaintiff did in this case. It is plaintiff's burden to present all facts supportive of its tax exemption claim at the administrative level. See American Science Foundation v. Commissioner, T C.M. (P-H) ¶ 86,556 (Nov. 20, 1986). There is no hint that plaintiff was inhibited in any way by the IRS in its presentation of material supportive of its position. Id. Plaintiff similarly was aware at that time that other adoption agencies had received an exemption. Its reference to The Golden Cradle organization, discussed supra, establishes this fact. The facts may have been different in other adoption exemption cases and most probably were. For example, plaintiff relies on Revenue ruling 80-200, supra. Yet as discussed in note 13, supra, the case at bar is distinguishable from that ruling.

plaintiff operated in a manner not "distinguishable from a commercial adoption agency." 19[19] The record supports the view that operation of an adoption agency is not an inherently charitable operation. For profit adoption agencies do exist. The record establishes a number of factors which characterize a "commercial adoption agency" and which are applicable to

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19 Plaintiff argues that the IRS determination fails to define in terms how a "commercial adoption agency" operates or to identify any such commercial adoption agencies by name. However, such specificity is not required. What is required is the presence in the record before the IRS of those factors which are "commonly associated with a commercial enterprise." See American Institute for Economic Research v. United States, supra, 157 Ct. Cl. at 556, 302 F.2d at 938. The language used by the IRS to which plaintiff directs criticism, is similar to language utilied by courts to capsule their conclusion, drawn from the record, that plaintiff's business operated in the manner of other similar businesses. See, e.g., Senior Citizens Stores, Inc. v. United States, 602 F.2d 711, 714 (5th Cir. 1979) ("plaintiff's business is not distinguishable from that of many, typical family operated businesses * * *.").

plaintiff's operation. Plaintiff's operation made substantial profits; there was a substantial accumulation of capital surplus in comparison to direct expenditures by plaintiff for charitable and educational purposes (i.e., the care and counseling provided destitute unwed mothers-to-be). See Scripture Press Foundation v. United States, supra; American Institute for Economic Research v. United States, supra. Plaintiff's operation was funded completely by substantial fixed fees charged adoptive parents; it relied entirely on those fees and sought no funds from federal , state or local sources, nor engaged in fund raising programs, nor did it solicit contributions B.S.W. Group, Inc. v. Commissioner, supra. Federation Pharmacy Services, Inc. v. Commissioner, supra. Indeed, plaintiff had no plans nor intention to seek contributions, government grants or engage in fund

raising relative to its operations. Too, plaintiff does not coordinate its adoption activities with any governmental adoption agencies. Further, the fixed fees plaintiff charged adoptive parents were not subject to downward adjustment to meet potential adoptive parents' income or ability to pay. See Murphy v. Commissioner, 54 T.C. 249, 250-51 (1970) (adoption agency qualified as charitable organization under section 170(c). Finally, plaintiff's organization was structured and operated more like a commercial organization. Its membership was organized into classes of memberships, single life member and ordinary members. Like a sole stockholder in a commercial corporation, the life member has inherent power and control and, like stock, such life membership is transferable. Like a

commercial corporation, plaintiff functions by means of a paid staff of 15 to 20 persons, with no volunteer help.

While these factors standing alone may or may not reflect the dominant commercial character of an organization, the totality of these factors, present in this record, clearly support the IRS determination that plaintiff's operation is not "distinguishable from a commercial adoption agency."

For the reasons set forth above, the court finds that the IRS determination of February 6, 1986 was correct. Therefore plaintiff is not entitled to the relief it requests. [20]

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[20] Plaintiff is certainly entitled to make another application for qualification under section 501(c)(3). If it prsents additional information to the IRS and its application is again rejected, plaintiff could file another declaratory judgment action. The new information plaintiff relied on would then be part of a new administrative record and available for the court to review. American Science Foundation v. Commissioner, supra, T.C.M. (P-H) ¶ 86,556; Houston Lawyers Referral Service v. Commissioner, 69 T.C. 570. 577-78

The complaint is to be dismissed. No cost.

(1976).

APPENDIX E

Internal Revenue Code and Treasury Regulation are in effect in years in issue; Internal Revenue Code 7195:

Sec. 501. EXEMPTION FROM TAX ON CORPORATIONS CERTAIN TRUSTS ETC.

* * *

(c) List of Exempt Organizations. -- The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, or substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to

influence legislation (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

Treasury Regulations of Income Tax (1954 Code)

Reg. § 1.501(c)(3)

(d) Exempt purposes. -(1) In general -(i) An organization may be exempt as an organization described in section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

(a) Religious.

(b) Charitable.

(c) Scientific

(d) Testing for public safety.

(e) Literary.

(f) Educational, or

(g) Prevention of cruelty to children or animals.

(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this paragraph unless it serves a public rather than a private interest, Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benifit of private interest such as designated individuals, the creator of his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interest

(iii) Since each of the purposes specified in subdivision (i) of this subparagraph is an exempt purpose in

itself, an organization may be exempt if it is organized and operated exclusively for any one or more of such purpose. If, in fact, an organization is organized and operated exclusively for an exempt purpose or purposes, exemption will be granted to such an organization, regardless of the purpose or purposes specified in its application for exemtion. For example, if an organization claims exemption an the ground that it is "educational." exemption will not be denied, if, in fact, it is "charitable."

(2) Charitable defined. - The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration is section 501(c)(3) of other tax-exempt

purposes which may fall within the board outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education of science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary

contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic charges or present opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) so long as it is not an "action" organization of any one of the types described in paragraph (c)(3) of this section.

APPENDIX F

Excerpts from Cover Story from *National Law Journal* dated February 9, 1987.

BABY BROKERS

How far can a lawyer go?

Excerpts from Cover Story from *National Law Journal* dated February 9, 1987 (continued):
By Michele Galen
National Law Journal Staff Reporter

Growing Numbers of attorneys are saying the can do what nature and adoption agencies cannot produce babies for every couple that wants one.

While adoption experts estimate that there are 40 couples for every available infant and that five-year waiting lists at adoption agencies around the country are common, these lawyers claim that through them, for fees ranging up to $30,000, anyone seeking a child can adopt.

"There's really a very large underground of people looking to adopt and girls who are looking to give their babies up for adoption," says adoption lawyer Lucille S. Rosenstock of Blauvelt, N.Y.'s Rosenstock & Lowe.

"The emphasis on tight supply and big demand—it isn't true," she adds. "Every couple who comes to us and wants to adopt can, often within less time than pregnancy takes."

Lawyers who deliver babies for a living—about 500 attorneys nationwide do this full time—are twice as numerous as a decade ago, according to the Washington, D.C.-based National Committee for Adoption Inc., a nonprofit group that represents private adoption agencies.

These lawyers usually specialize in healthy white infants, once the lifeblood of state adoption agencies now suffering from depressed birth rates and the growing social acceptability of delayed pregnancy, single parenthood or abortion, experts say.

Such attorneys use methods that run from the seemingly ethical to the questionably illegal, from attorneys who shun high fees or prohibited adoption procedures, to those who

traffic in the "black market": purchasing infants from pregnant women by giving them generous living allowances or paid vacations and then charging couples fat fees for babies the lawyers may not deliver.

Most adoption lawyers, however, are somewhere in between, where laws are cloudy and professional ethics are fuzzy.

In this group, experts say, fall three basic types of attorneys:

- Those who represent the natural mother and the adoptive parents, raising the specter of a conflict of interest.

- Those who operate as adoption agencies by arranging child placements or keeping lists of adoptive clients.

- Those whose fees or litigation practices totter on the line of legality.

Three well-known adoption attorneys personify the middle range. The most controversial is Seymour Kurtz, a charming yet litigious Chicago-based attorney who heads a multistate adoption network attacked by regulators and prosecutors nationwide for alleged tax and licensing violations, excessive fees and coercive adoption practices.

At either extreme are Dallas' Robert I. Kingsley, a "baby broker" recently sentenced to prison for baby selling; and New York's Ms. Rosenstock, a conservative and highly regarded practitioner with set fees who advises couples to advertise in the newspapers for babies and only occasionally represents birth mothers and adoptive parents simultaneously.

A fourth adoption lawyer, Santa Ana, Calif's. Christian R. Van Deusen of Christian R. Van Deusen Inc., represents a new trend, according to experts. A well-known maverick, Mr. Van Deusen turned from handling real estate deals to representing adoptive couples in custody fights

with natural parents after a three-year battle over his own adopted daughter.

The lawyer-arranged independent adoption market, experts and judges say, takes advantage of vague and inconsistent state adoption laws—weaknesses aggravated in recent years by the adoption market's shift from licensed, public adoption agencies to private attorneys.

"Children have moved from being objects of commendable, charitable contributions from religious and non-profit groups to become commodities in multi-million-dollar businesses," says Surrogate Judge Bertram R. Gelfand of Bronx, N.Y.

The judge recently called for a state investigation into the Interstate Compact on the Placement of Children, which was intended to ensure the well-being of children placed in out-of-state homes but in fact is circumvented by lawyers and agencies often seeking exorbitant fees and expediency.

Says Betsey R. Rosenbaum, project manager for the Washington, D.C.-based American Public Welfare Association, which administers the compact, "There's nothing uniform about adoption laws, fees, or anything else in this country."

While every state prohibits "baby selling," the placement of children for value, only four state also ban non-agency, or independent, adoptions by lawyers or other intermediaries: Delaware, Massachusetts, Michigan and Minnesota.

Lawmakers in those states reason the licensed adoption agencies best protect the child's interest by limiting fees, requiring psychological counseling of pregnant women and screening of adoptive couples by objective social workers and lawyers.

In jurisdictions where independent adoptions are legal, including California, New York and Texas, there are few

guidelines as to what intermediaries can do and what money can change hands.

Fewer than a handful of states, for instance, set maximum adoption fees. Rather, most permit adoptive parents to apply for the natural mother's "reasonable and necessary" legal and medical expenses—without defining what those costs include or sanctioning possible fee violators, judges and experts say.

And because state laws differ, adoption lawyers often forum shop, judges say.

"They're going to a court where they can get the biggest fees and the judges don't ask many questions of the natural mothers about how much they've been paid," says Supreme Court Justice Lawrence Martin Jr. of Westchester, N.Y., a trial judge who advocates tighter and tougher adoption laws.

Attorney Kurtz, to many experts, illustrates the laws' weaknesses.

A once high-powered trial attorney, who had served as personal counsel to the prominent lawyer Roy Cohn, Mr. Kurtz says he bagan specializing in adoptions in 1960 because "I liked it, it was a nice thing to do."

According to "The Baby Brokers," a 1980 book by New York City journalist Lynne McTaggart that probed the practices of Mr. Kurtz and other adoption lawyers, the Chicago attorney has engineered a complex adoption network the author believes is designed to circumvent American law and social welfare regulations.

As of the late 1970s, Mr. Kurtz's network included profit and non-profit foundations and offices in the United States, Mexico and Holland, the book notes. The foreign operations—serving as sources of pregnant women—closed in 1977, according to Ms. McTaggart.

At that time, Mr. Kurtz said his agencies enabled him to promote humanitarian goals without government subsidies or personal profit, the book notes.

Now the attorney says he runs four adoption agencies: Chicago-based Easter House; Atlanta-based Friends of Children; Phoenix, Ariz.-based Birth Hope; and Washington, D.C.-based American Friends of Children.

But he has visions of being everywhere.

"We are trying to be operational in the entire country," he says, adding that in 1986 his agencies placed—for a fee of $16,500 to $18,000 to the adoptive parents—239 healthy infants, most of them white, and spent about $700,000 on national advertising to attract birth mothers, women who for varying reasons seek to relinquish custody of their infants.

Mr. Kurtz maintains his agencies allow him to conduct independent adoptions in a structured "set-up" and to prevent biological mothers from seeking abortions.

"The name of the game is to offer young women a viable alternative to abortion," says Mr. Kurtz.

But in licensing hearings and independent investigations, growing numbers of state adoption officials and attorneys general are questioning Mr. Kurtz's motives.

"I consider this the grand baby-selling scheme," says Robert S. Segelbaum of Phoenix, and assistant attorney general in Arizona, who along with the state Department of Economic Security denied Birth Hope a license. He is now fighting Mr. Kurtz in an administrative hearing over that decision.

"This is the typical case where their only interest is grabbing the child and selling it for $16,500," adds Mr. Segelbaum, expressing conerns outlined in a Sept. 19, 1986, letter to Mr. Kurtz amending the economic security department's denial of Birth Hope's license. The amending

letter charges that the adoption agency committed fraud, caused duress and engaged in undue influence in the placement and solicitation of adoptive parents.

Those supplemental charges followed a 2 1/2-month probe by the department, Mr. Segelbaum adds.

Arizona's dispute with Birth Hope mirrors disputes with Friends of Children in Florida and Easter House in Illinois.

In New Jersey, Friends of Children was refused a license, and in Missouri, the adoption agency dropped its application after police arrested a caseworker in 1984, in a sting operation for running an unlicensed child-placement agency, according to Shirley Hickman, a licensing expert with the state Division of Family Services.

According to the Arizona attorney general office's written charges, Birth Hope's practices include:

• Coercing natural mothers to turn over their infants by isolating the women from family and friends, denying them counseling and enticing them with generous living allowances and luxury vacations. When they change their minds, Mr. Segelbaum notes, the women are "dropped like hot potatoes."

• Misrepresentations about its state licensing and federal tax status; and

• Non-compliance with federal unemployment insurance laws by failing to file quarterly wage and contribution reports and not supplying its employees with W-2 and W-4 tax forms.

In one instance, the attorney general's office claims Birth Hope offered to send the biological mother of two toddlers on a $1,000 Hawaiian vacation, and to pay the father's $652 rent and make car payments in order to induce the father to terminate his parental rights.

But Mr. Kurtz defends his agency's operations, and says the state's suit is 'completely without merit. I have every confidence I'll be vindicated in it."

And the lawyer vehemently denies he is engaged in baby selling.

Rather, he claims, he is the victim of "scurrilous attacks" by "powerful" government officials. As proof, he cites a ruling last June awarding him $200,000 in a 10-year-old federal harassment suit against officials and a former employee of the Illinois Department of Children and Family Services (DCFS). *Easter House v. Felder*, 76-1170 (N.D. Ill.).

The case is now on appeal to the 7th U.S. Circuit Court of Appeals.

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